

General Information Letter: Taxation of trusts making qualified funeral trust election under Taxpayer Relief Act of 1997.

May 22, 1998

Dear:

This is in response to your letter to Director Zehnder dated May 14, 1998, in which you request a General Information Letter. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information we have enclosed a copy of 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the information you have provided requires that we respond with a general information letter.

In your request you stated:

I would like to bring to your attention an item that impacts the xxxxxxxx xxxxxxxx xxxxxxxxxxxx xxxxxxxxxxxxxx and it's xxxxxx funeral homes. At issue is the tax treatment of qualified funeral trusts. Qualified funeral trusts were created as part of the Taxpayer Relief Act of 1997. Congress authorized this new type of trust by creating Internal Revenue Code section 685. Attached is a one page summary of the tax treatment of funeral trusts. Trustees currently have two options in reporting the taxable income of the trust.

One option is to treat the funeral trust as a grantor trust. Under this option, the annual earnings of the trust are taxed to the purchaser/grantor of the trust. A second option is to treat the funeral trust as a qualified funeral trust. Under this option, the annual earnings of the trust are reported by and taxed to the trust itself.

The Internal Revenue Service created a new form, Form 1041-QFT, to allow for the reporting of income and deductions for qualified funeral trusts. Attached is a copy of this form.

The dilemma we face, at this point, is that under the first option shown above the earnings are reported by the individual purchaser on his/her individual income tax return, Form IL-1040, at the individual rate. However, under the second option shown above, the earnings are reported by the trust on Form IL-1041. As a result, it appears that

the earnings are subject to both the income tax and the replacement tax. If this is the case, it is clearly inequitable.

We would like to address this inequity and provide a reporting mechanism for qualified funeral trusts in the State of Illinois. We would like to meet to discuss this important item with you or your staff at the earliest convenience. If we can provide additional information or background materials, please contact me.

Department Analysis

Your letter to Director Zehnder has been forwarded to myself for reply. The information in your letter is correct as regards the treatment of income of a qualified funeral trust. Under Illinois law, a qualified funeral trust would be subject to the personal property replacement tax if that option is used. While this may seem unfair, this is the method which the Illinois legislature has chosen to use for the taxing of trusts. As with all investments, there are benefits and detriments to choosing the trust format. The fact that electing to be a qualified funeral trust may be beneficial for federal income tax purposes does not automatically mean the election will or should be beneficial for Illinois income tax purposes, and the trustee should be aware of all aspects of the election before making the election.

I hope that this has been helpful to you. If you have additional questions please feel free to contact me at the above address.

Sincerely,

Charles E. Matoesian
Associate Attorney (Income Tax)